Sunfire Energy Corporation

December 31, 2000 Annual Report

CORPORATE PROFILE

Sunfire Energy Corporation is a Calgary based company engaged in the exploration, development and production of crude oil and natural gas.

The Company presently confines its exploration and development activities to a limited number of areas in Western Canada where it has developed expertise.

The Company's primary objective is to build shareholder value through the discovery, development and acquisition of crude oil and natural gas.

The Company is headquartered in Calgary and its common shares are listed on The Canadian Venture Exchange under the trading symbol **SFE.A**.

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ANNUAL GENERAL MEETING

Shareholders are invited to attend the Annual General Meeting of the Corporation which will be held at the Metropolitan Centre, 333 - 4th Avenue S.W., Calgary, Alberta on June 18, 2001 at 3:00 p.m.

HIGHLIGHTS

FINANCIAL

FISCAL YEARS	12 months ended Dec. 31, 2000	12 months ended Dec. 31, 1999
	$	$
Gross Revenue, less royalties	8,700,132	3,344,946
Cash flow from Operations	6,143,442	2,666,409
Per Share *	0.58	0.29
Net income	2,416,326	1,204,065
Per Share *	0.23	0.13
Net Capital Expenditures	17,140,335	5,497,540
Shareholders' Equity	16,389,004	11,597,375
Number of Common Shares Outstanding at Year End	12,066,573	10,102,573

* Based upon the weighted average number of common shares outstanding during the fiscal year, ended Dec. 2000 – 10,524,880; Dec. 1999 – 9,165,814.

OPERATIONS

FISCAL YEARS	12 months ended Dec. 31, 2000	12 months ended Dec. 31, 1999
Production		
Crude Oil (Bbls/d)	70	2
Natural Gas (Mcf/d)	5,370	3,670
Reserves – Proven & Probable		
Crude Oil (Mbls)	332	5
Natural Gas (Bcf)	29.4	27.7
Present Value of Reserves – Proven & 50% Probable (discounted at 12% before taxes)	$48,126,000	$27,197,000
Undeveloped Land Holdings		
Gross Acres	93,188	66,796
Net Acres	49,868	37,771

ABBREVIATIONS

Bbls	Barrels
Bbls/d	Barrels per day
Mbls	Thousand of barrels
Mcf	Thousand cubic feet
Mcf/d	Thousand cubic feet per day
MMcf	Million cubic feet
Bcf	Billion cubic feet
ARTC	Alberta Royalty Tax Credit
BOE	Barrels of Oil Equivalent 10 Mcf = 1BBL

PRESIDENT'S MESSAGE

Sunfire's accomplishments in 2000 were very significant. The highlights of the year are as follows:

- The purchase of Braegan Energy Ltd. added production volumes and, more importantly, provided several exploration and development opportunities
- Two new core areas at Lodgepole and Blackfoot were established
- Drilled a total of 20 wells (15 successes) with 90% of the wells drilled in core areas
- Drilled a successful exploratory well at Buick Creek, B.C. which the Company expects to develop in 2001
- Production volumes increased by 64% to 607 BOE/d
- Cash flow per share increased by 100% to $0.58/share
- Cash flow per share increased in each successive quarter, as follows: $0.09, $0.11, $0.15 and $0.24
- Earnings per share increased by 77% to $0.23/share
- Increased the technical team by 2 resulting in a total of 7 employees at year-end

Sunfire will continue to grow through a combination of exploration and development and strategic acquisitions. The Company anticipates capital expenditures of $12 MM for exploration and development activity in 2001 and has available a significant amount of additional capital for acquisitions. The capital expenditure program will be financed by a combination of cash flow and debt capacity.

Subsequent to year-end 2000, Sunfire has drilled additional wells at each core area and is expecting incremental production volumes at each area. In addition to the ongoing drilling programs within the core areas and the development program at Buick Creek, the Company has increased its prospect inventory. Sunfire intends to invest in several new drilling prospects in 2001.

The business environment for oil and gas producers continues to look very attractive. Gas prices have reached record levels recently and appear to show continued signs of strength for the next few years. In addition, the low Canadian dollar, low interest rates and reasonable oilfield service and supply costs enhance the profitability of the sector. Current acquisition trends such as the growth of royalty trusts and acquisitions by large U.S. companies suggest that the number of opportunities for smaller oil and gas companies will increase in the future. The combination of strong economic fundamentals, an increasing inventory of prospects and a strong team of people suggest that Sunfire will continue to be successful in the future.

In summary, Sunfire has had an excellent year and the future looks very promising. I would like to thank all Sunfire's stakeholders – shareholders, directors, employees, consultants and suppliers for their continued support, advice and commitment.

On behalf of the Board of Directors

G.C. Merritt
President & C.E.O.


N.E. BRITISH COLUMBIA
ALBERTA
BUICK CK.
Peace River
Fort St. John
THORHILD
Edmonton
LODGEPOLE - BRAZEAU
Red Deer
Calgary
BLACKFOOT
Lethbridge
MAJOR PROPERTIES

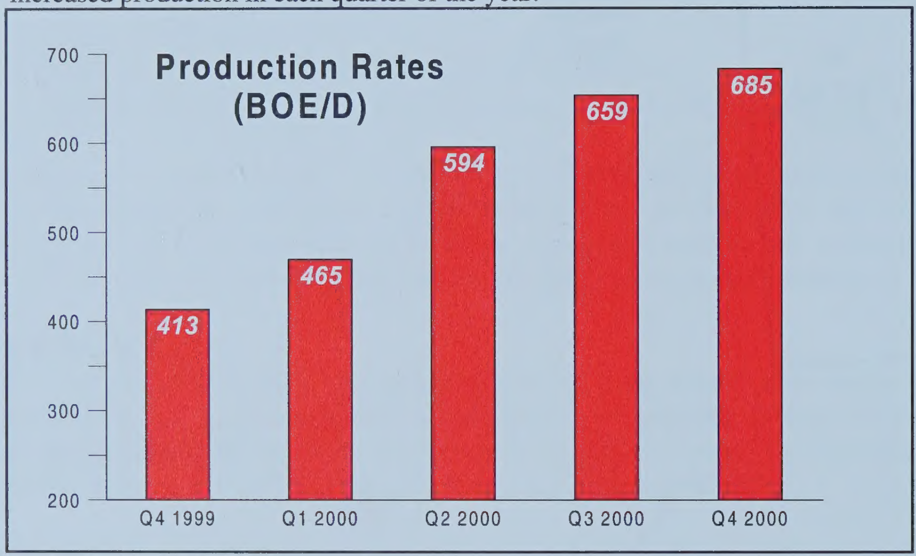
OPERATIONS REVIEW

PRODUCTION

Average daily production volumes in 2000 increased by 64% over 1999. Gas volumes averaged 5.37 MMcf/D and oil production was 70 BOPD. Increases in production were due to a combination of exploration and development activity and acquisitions. Production during the year was from the following properties:

	OIL & NGL (BBL/D)		GAS (MMcf/D)		BOE/D	
	Average	Exit	Average	Exit	Average	Exit
Thorhild	0	0	3.10	3.20	310	320
Lodgepole	57	57	1.20	1.80	177	237
Blackfoot	11	20	0.27	0.70	38	90
Other	2	3	0.80	1.80	82	183
TOTAL	70	80	5.37	7.50	607	830

The Company increased production in each quarter of the year:



DRILLING

Sunfire participated in the drilling of 20 wells of which 15 were successful resulting in a 75% success ratio. 90% of the wells were drilled in the Company's core areas. The results are as follows:

	EXPLORATION		DEVELOPMENT		TOTAL	
	GROSS	NET	GROSS	NET	GROSS	NET
Oil	1	0.4	0	0.0	1	0.4
Gas	5	3.5	9	5.6	14	9.1
Dry	4	3.5	1	1.0	5	4.5
TOTAL	10	7.4	10	6.6	20	14.0

LAND

Sunfire's land position increased in 2000. Net undeveloped acreage inventory increased by 32% over 1999. Additional land was acquired at crown land sales and by acquisitions and farmins. The Company's land position is summarized below:

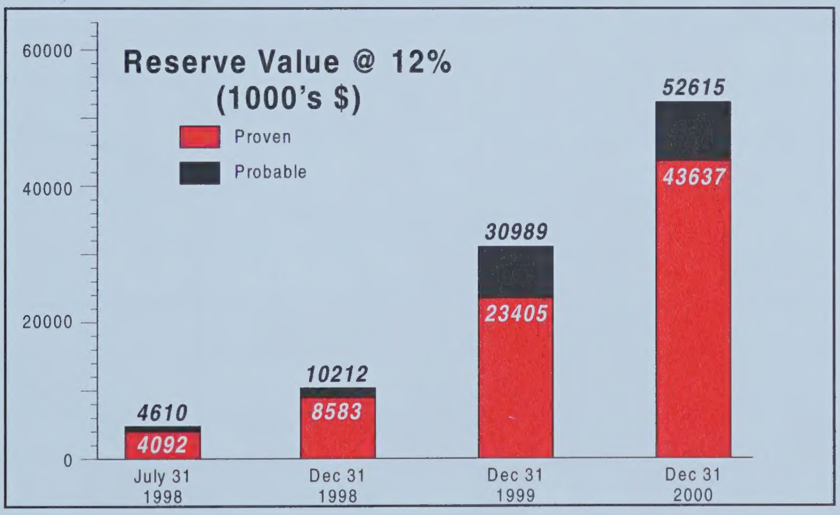
	DECEMBER 31, 2000		DECEMBER 31, 1999	
	GROSS ACRES	NET ACRES	GROSS ACRES	NET ACRES
DEVELOPED	66,280	30,751	40,809	19,490
UNDEVELOPED	93,188	49,868	66,796	37,771
	159,468	80,619	107,605	57,261

RESERVES

The Company's reserves were estimated at January 1, 2001, by the independent petroleum engineering firm of Martin & Brusset Associates of Calgary. The volumes and estimated present value of the Company's proved and probable reserves, as determined by Martin & Brusset, are shown in the following table. The values are forecast after the payment of operating expenses, capital costs and royalties, but prior to the payment of income taxes and indirect costs such as general and administrative expenses.

PETROLEUM AND NATURAL GAS RESERVES AND NET PRE-TAX CASH FLOWS

	Corporation's interest in reserves				Present worth of future net pre-tax cash flows			
	Crude Oil & NGL (Mbls)		Natural Gas (MMcf)		Discounted at			
	Gross	Net	Gross	Net	0%	10% (thousands of $)	12%	15%
Proved								
Producing	203	177	14,040	10,475	46,401	35,404	34,007	32,182
Non-producing	32	23	7,148	5,167	18,492	10,462	9,630	8,610
Total Proved	235	200	21,188	15,642	64,893	45,866	43,637	40,792
Probable Additional	175	155	8,214	5,653	23,539	10,110	8,978	7,645
Total including ARTC	**410**	**355**	**29,402**	**21,295**	**88,432**	**55,976**	**52,615**	**48,437**
Less risking of Probable Additional @ 50%	87	77	4,107	2,826	11,769	5,055	4,489	3,822
TOTAL	**323**	**278**	**25,295**	**18,469**	**76,663**	**50,921**	**48,126**	**44,615**



The estimate of future net revenue is based on the following price forecast prepared by Martin & Brusset

	Gas - Alberta Spot ($CDN/MMBTU)	Oil – Edmonton Light Sweet ($CDN/BBL)
2001	7.25	38.50
2002	5.50	31.75
2003	4.00	30.00
2004	4.00	30.00
2005	4.00	30.50

CAPITAL EXPENDITURES

Capital expenditures increased in 2000 over the previous year. Capital associated with exploration and development activities increased by 77% to $9.4 MM. Capital expenditures for acquisitions were a total of $7.6 MM which includes the purchase of Braegan and two property purchases at Lodgepole. The capital expenditures were distributed as follows:

	12 mos. Ending Dec. 31, 2000	12 mos. Ending Dec. 31, 1999
Land	**566,439**	613,513
Seismic	**390,989**	229,857
Drilling & Completions	**4,545,314**	3,353,603
Facilities	**3,874,510**	1,104,133
Total Exploration/Development	**9,377,252**	5,301,106
Property purchases	**2,052,630**	175,000
Corporate acquisitions	**5,558,515**	
Other	**151,938**	56,444
TOTAL	**17,140,335**	5,532,550

MARKETING

In 2000, 95% of Sunfire's natural gas production was sold to the spot market. Sunfire attempts to reduce the commodity price risk associated with the capital program by fixing commodity prices when appropriate. Throughout the year, the Company had several fixed price contracts in place on a portion of gas production. The average price of those contracts was $3.97/MCF on 65% of gas production. The average price realized on all gas production was $4.81/MCF. As of year-end 2000, the Company has fixed the price at $5.04/MCF on 3.8 MMcf/D until March 31, 2001 and has no fixed price contracts in place after March 31, 2001.

MAJOR PROPERTIES

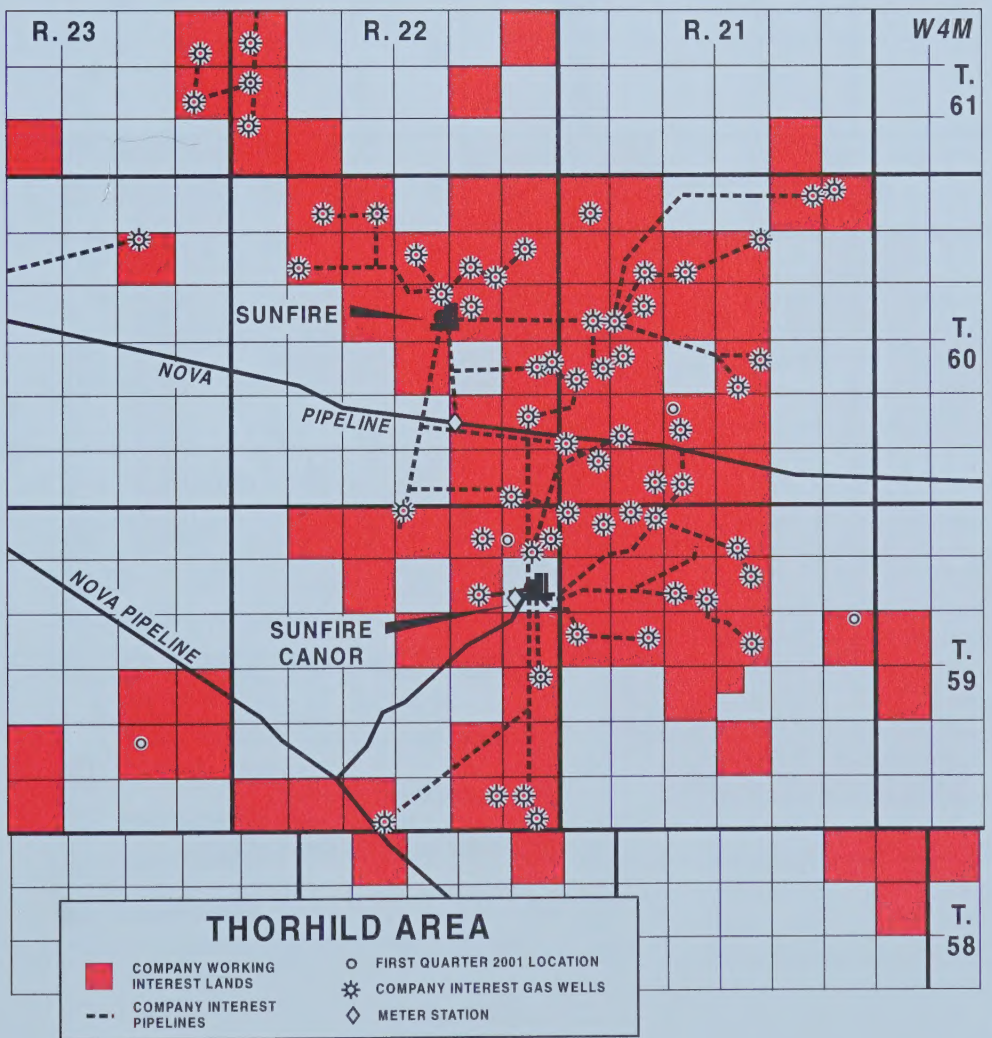
THORHILD, ALBERTA

Sunfire has an interest in 120 sections of land at Thorhild, 45 miles northeast of Edmonton. The Company has an average working interest of 70% and the majority of the wells are operated by Sunfire. There are seven different producing zones at depths up to 850m. Sunfire has an interest in 2 gas plants, one of which is Company operated. Operating costs in 2000 were $0.35/Mcf.

In 2000, Sunfire accomplished the following:

- Drilled 6 wells of which 4 were successful
- Tied-in 4 wells
- Recompleted 14 wells

The Company plans to continue to develop the Thorhild property. Subsequent to year-end, 5 wells have been drilled resulting in 4 gas wells and one dry hole. The Company expects to evaluate the new wells and place them on production in the third quarter. Further drilling programs are anticipated in the second half of 2001.

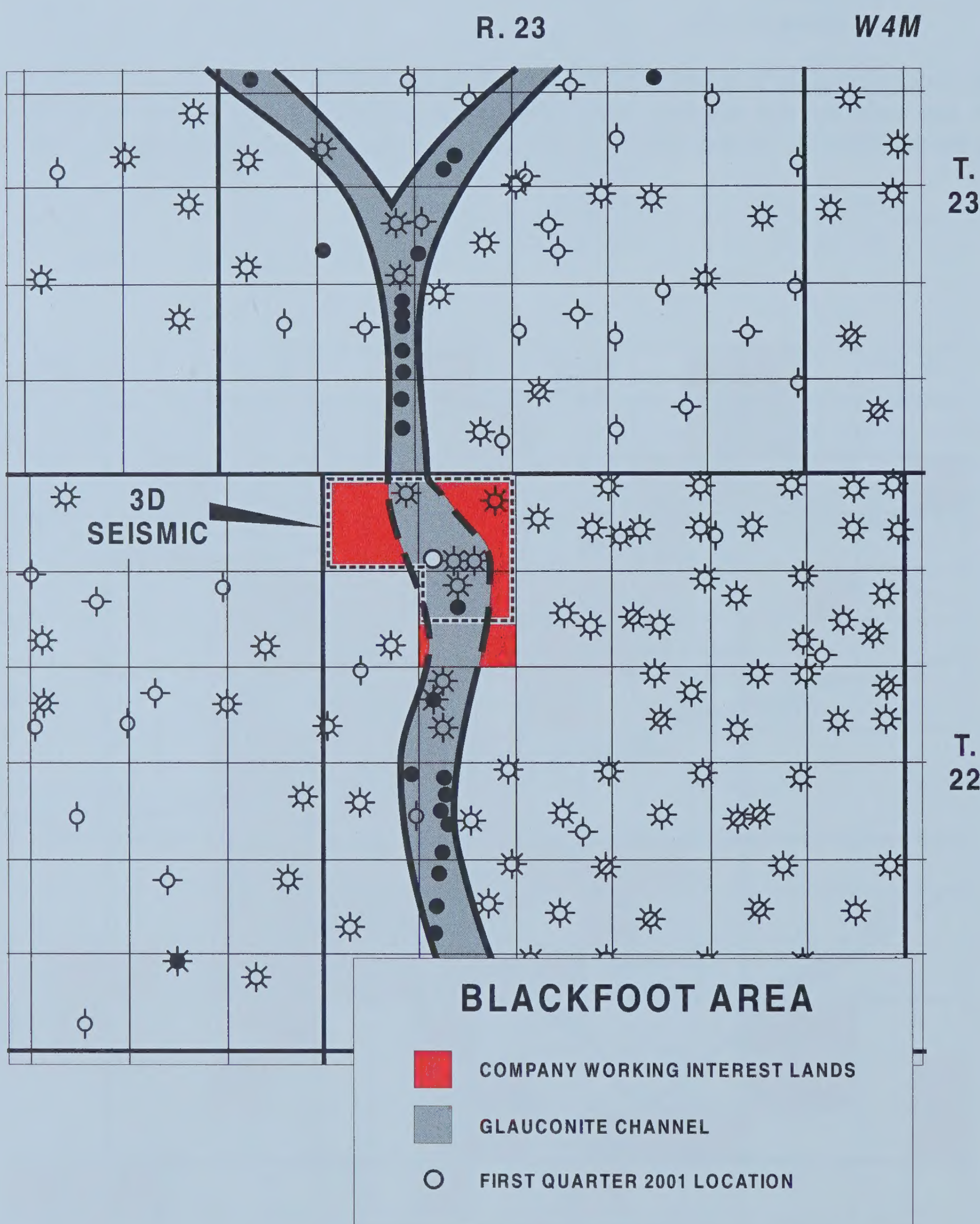


BLACKFOOT, ALBERTA

Sunfire has a 37.5% interest in 3 sections of land at Blackfoot, located 30 miles east of Calgary. The primary producing zones are Glauconite and Bow Island. In 2000, Sunfire participated in the drilling of 5 wells (1.9 net), all of which were cased. Three wells were tied-in and put on production during the year and a fourth well was placed on production in April, 2001. The Company produces sweet gas and sweet light oil (37° API). Operating costs average \$5.00/BOE. Gas volumes are sold to the spot market.

Subsequent to year-end, the Company drilled a successful well which is expected to be on production before year-end 2001. Net production volumes at year-end 2000 were 700 Mcf/D and 20 Bbls/D of Liquids.

Sunfire expects to drill several more wells in 2001.

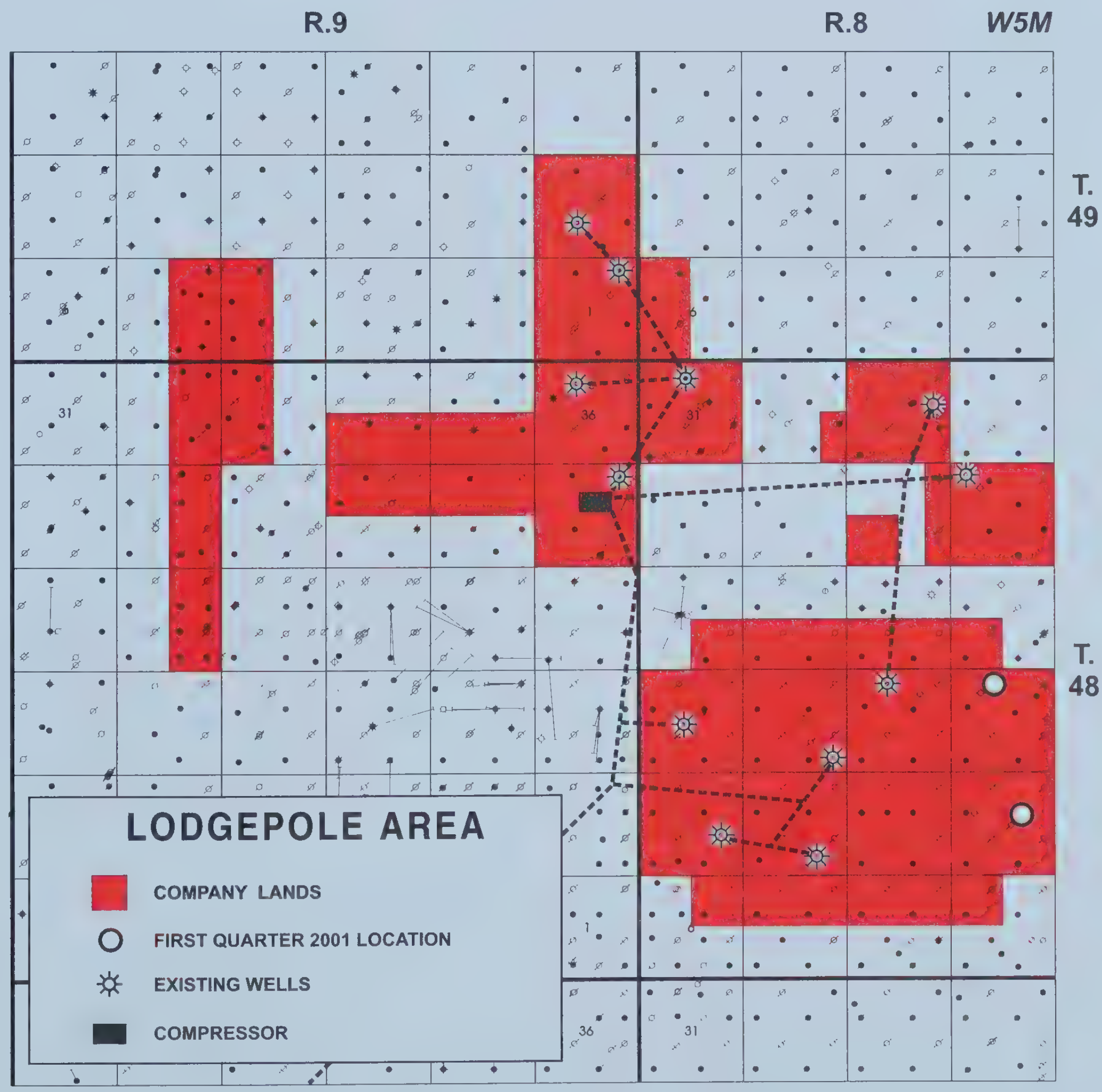


LODGEPOLE, ALBERTA

Sunfire has an interest in 25 sections of land at Lodgepole, located 60 miles southwest of Edmonton. The Company produces sweet natural gas from the Paskapoo and Edmonton sands and oil from the Cardium zone. At year-end 2000, Sunfire operated a total of 13 gas wells and 8 oil wells at an average working interest of 70%. Operating costs in the year were \$9.00/BOE. Operating costs were high due to the payment of gathering, compression and processing fees to a third party. In November, 2000 Sunfire installed a compressor to deliver gas directly to sales and reduce the third party costs. Operating costs in 2001 are anticipated to be \$5.00/BOE. The Company experienced a very high level of activity in 2000 as follows:

- Drilled 7 wells (5 successes)
- Purchased a 100% interest in 4 producing gas wells
- Installed a compressor in November, 2000 to deliver gas directly to sales and reduce operating costs
- Tied-in 5 wells to the gathering system

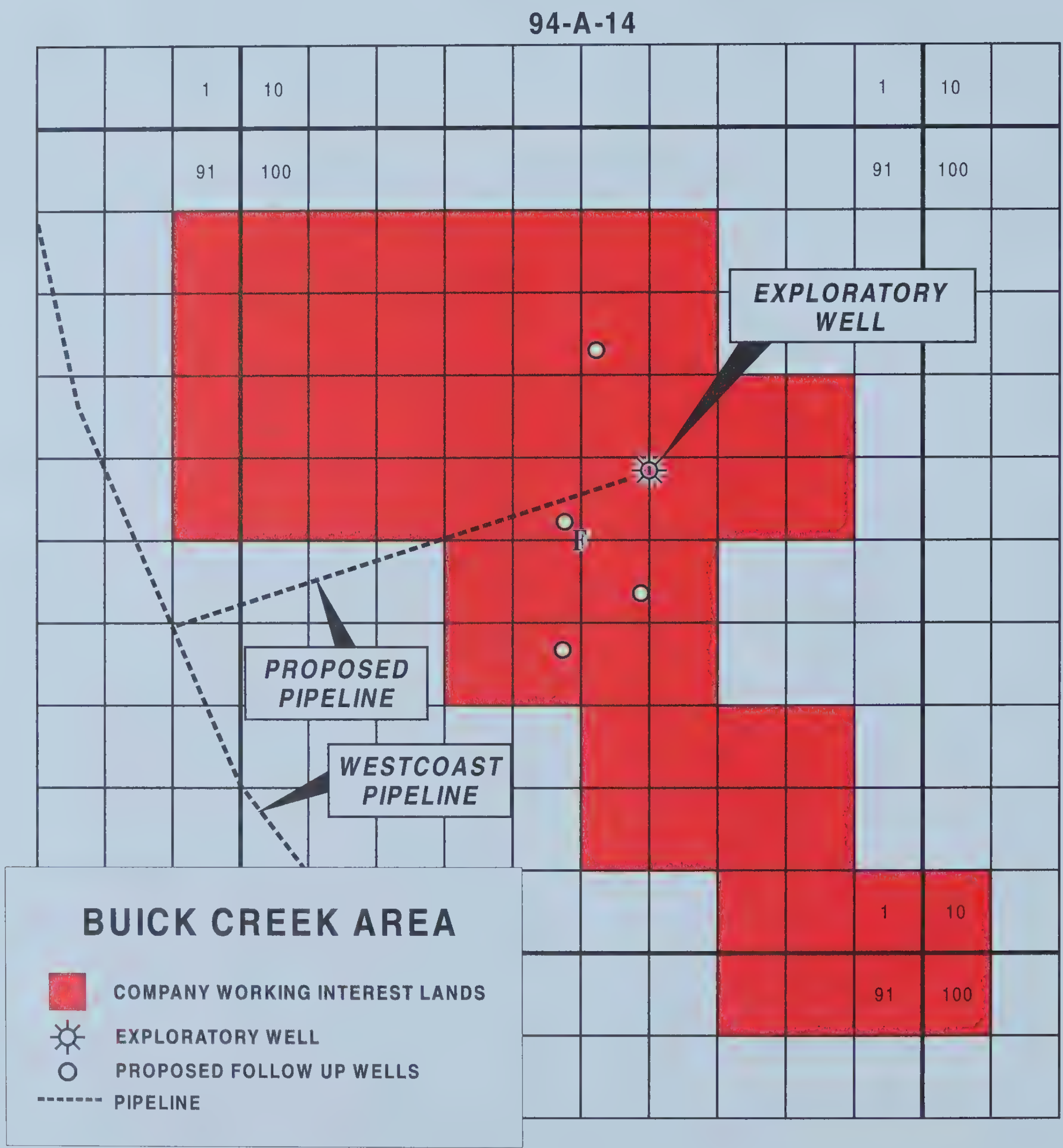
Subsequent to year end, Sunfire drilled 5 wells during the first quarter, 2001. These wells are currently being evaluated. Future drilling programs are planned for the remainder of 2001. Gas volumes from this area are sold to the spot market.



BUICK CREEK, B.C.

Sunfire has an interest in 14 sections of land in Buick Creek, which is 30 miles north of Fort St. John, B.C. The land is prospective for Baldonnel, Halfway, Debolt and Slave Point production. In Dec. 2000, Sunfire participated (40% working interest) in an exploratory well. The well encountered hydrocarbons in the Baldonnel, Halfway and Debolt zones. The discovery well was subsequently completed, and tested gas in the Halfway zone at 1.5 MMcf/D. The well is expected to be put onstream in July, 2001.

Several follow-up locations have been identified and the first follow-up well is scheduled to be drilled in June, 2001.



MANAGEMENT'S DISCUSSION AND ANALYSIS

REVENUE

Total revenue from oil and gas sales in 2000 almost tripled compared to 1999. The increase was due to increased production volumes (64%) and higher prices (79% increase).

ROYALTIES

Royalties increased by a factor of six over the previous year. Alberta Royalty tax credits as a percentage of crown royalty was reduced significantly and the amount paid by Sunfire in overriding royalties increased.

OPERATING COSTS

Total operating costs and the cost per BOE increased due to the purchase of Braegan Energy in March, 2000. The operating costs associated with the Braegan assets were $9.40/BOE which increased the total Company weighted average cost to $6.84/BOE from $4.08/BOE in 1999. Operating costs are expected to decrease in 2001 due to the installation of compression at Lodgepole.

DEBT / INTEREST COSTS

Bank debt throughout the year increased from nil at the beginning of the year to $5,644,940 at the end of the year resulting in an increase in interest costs over the period. At year-end two bank lines existed. Sunfire had a $7.7 MM line at the HongKong bank and Braegan had a $1.8 MM line at the Alberta Treasury Branch ("ATB"). Braegan was amalgamated with Sunfire at year-end and the $1.8 MM line at the ATB was eliminated. Sunfire also entered into capital leases, totalling $2.0 MM, for the purchase of two compressors.

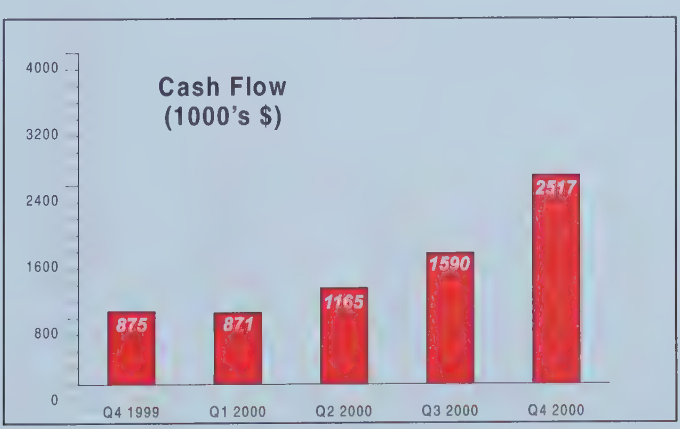
GENERAL AND ADMINISTRATIVE EXPENSES

Costs associated with G & A were $481,695 ($2.17/BOE) compared to $214,107 ($1.59/BOE) in 1999. Increasing costs are due to the addition of 2 employees during the year.

CASH FLOW

Cash flow in 2000 increased by 130% over 1999. Total annual cash flow was $6,143,442 (58¢/share) and increases were realized in each quarter throughout the year. Netbacks were $27.65 per BOE. The components of cash flow per BOE are as follows:

	TOTAL ($)	$ per BOE
Revenue	10,911,794	49.11
Royalties (net of ARTC)	2,211,662	9.96
Operating Costs	1,518,677	6.84
G & A	481,695	2.17
Interest	506,318	2.28
Large Corporation Tax	50,000	0.21
Netback	6,143,442	27.65



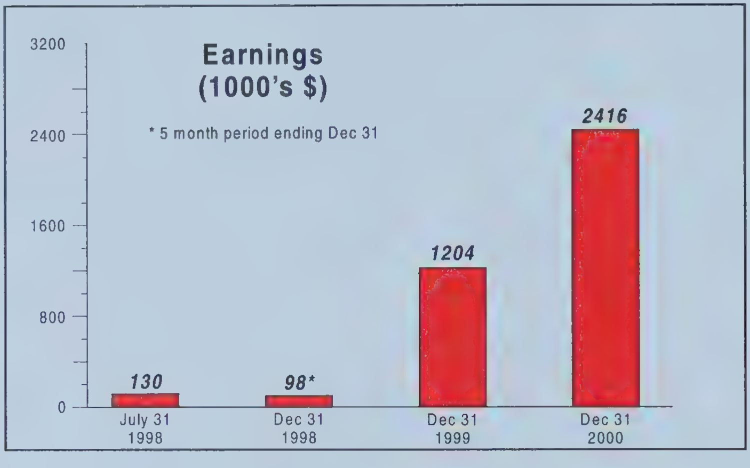
FINDING AND DEVELOPMENT COSTS

Reserve additions from the capital projects, including acquisitions, were 1665 MBOE of proven and 2357 MBOE of proven plus probable reserves. 90% of the reserve additions were natural gas. The finding costs for the year and corresponding recycle ratios are as follows:

	F & D COST ($/BOE)	RECYCLE RATIO
Proven	11.05	2.5
Proven plus 50% Probable	9.15	3.0
Proven plus Probable	7.81	3.5

EARNINGS

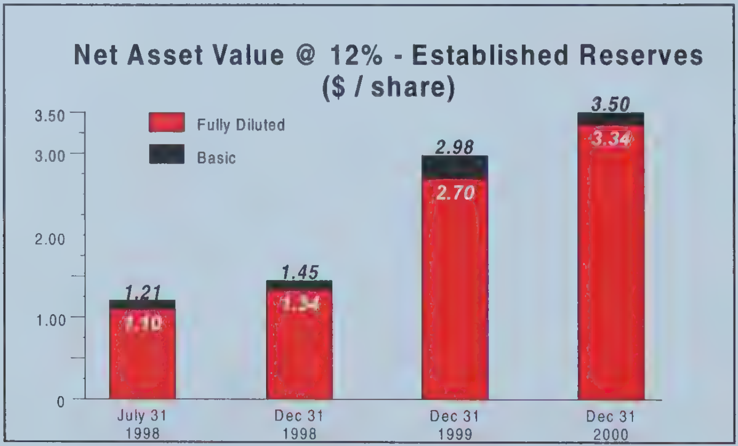
Corporate earnings in 2000 were $2,416,326 which was an increase of 100% over 1999. Higher production and stronger commodity prices were the primary reasons for the increase.



NET ASSET VALUE

The Company's net asset value calculation is as follows ($ MM):

	10% D.F.	12% D.F.	15% D.F.
Reserves – proven plus 50% probable	50.9	48.1	44.6
Undeveloped Land @ $65/acre	3.3	3.3	3.3
Debt plus Working Capital	(9.1)	(9.1)	(9.1)
	45.1	42.3	38.8
Per share – Basic ($)	3.73	3.50	3.21
– Fully Diluted ($)	3.56	3.34	3.08



INCOME TAXES

The Company has adopted a new accounting standard for the recognition, measurement, presentation and disclosure of income taxes. This new standard requires the use of the liability method of tax allocation accounting, whereby the measurement of future tax assets or liabilities will be based on a balance sheet approach rather than the income statement approach under the deferral method. At Dec. 31, 2000 and Jan. 1, 2001, Sunfire had the following tax pool balances:

	Dec. 31, 2000	Jan. 1, 2001
CEE	5,204,184	2,604,036
CDE	2,032,097	1,422,468
COGPE	6,127,901	5,515,111
CCA	7,215,126	6,007,457
OTHER	791,106	133,862
TOTAL	21,370,414	15,682,934

AUDITED FINANCIAL STATEMENTS
December 31, 2000

MANAGEMENT'S REPORT TO THE SHAREHOLDERS

The accompanying financial statements are the responsibility of management and have been prepared in accordance with accounting principles generally accepted in Canada.

Management acknowledges responsibility for the integrity of the financial statements and all other financial information in this annual report. Where appropriate, management has made informed judgments and estimates in accounting for transactions which affect the current accounting period but cannot be finalized with certainty until future periods. Company policies and procedures have been implemented to reasonably ensure that transactions are appropriately authorized, assets are safeguarded from loss and financial records are maintained. To further minimize risk, management maintains adequate systems of internal control.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and has appointed an Audit Committee. This committee, consisting of a majority of non-management directors, meets with management and external auditors to ensure that each group is properly discharging its responsibilities and to discuss internal control, accounting policies and financial reporting matters. The Audit Committee has reviewed the financial statements and has reported thereon to the Board of Directors. The Board of Directors has approved the financial statements for issuance to the Shareholders.

G.C. Merritt President	P.W. Goodman Secretary Treasurer

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of Sunfire Energy Corporation as at December 31, 2000 and the consolidated statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2000 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at December 31, 1999 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated February 16, 2000.

KPMG LLP

Chartered Accountants
Calgary, Canada
March 23, 2001

SUNFIRE ENERGY CORPORATION

Consolidated Balance Sheet

December 31, 2000, with comparative figures for 1999

	2000	1999
Assets		
Current assets:		
Cash	$ 9,141	$ 2,237,770
Accounts receivable	3,726,748	1,114,765
Prepaid expenses	119,968	3,267
	3,855,857	3,355,802
Petroleum and natural gas properties (note 4)	33,099,845	12,172,590
	$ 36,955,702	$ 15,528,392
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 5,398,141	$ 2,577,494
Income taxes payable	50,000	–
Current portion of obligations under capital lease (note 6)	446,851	–
	5,894,992	2,577,494
Long-term debt (note 5)	5,644,940	–
Obligations under capital lease (note 6)	1,465,602	–
Provision for future site restoration	285,209	114,023
Future income taxes (note 8)	7,275,955	–
Deferred income taxes	–	1,239,500
Shareholders' equity:		
Share capital (note 7)	11,051,398	8,676,095
Retained earnings	5,337,606	2,921,280
	16,389,004	11,597,375
	$ 36,955,702	$ 15,528,392

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Douglas Mitchell, Chairman

Geoffrey Merritt, Director

SUNFIRE ENERGY CORPORATION

Consolidated Statement of Income and Retained Earnings

Year ended December 31, 2000, with comparative figures for 1999

	2000	1999
Revenue:		
Petroleum and natural gas sales	$ 10,911,794	$ 3,695,766
Less royalties and Alberta Royalty Tax Credit	(2,211,662)	(350,820)
	8,700,132	3,344,946
Interest and other income	–	86,262
	8,700,132	3,431,208
Expenses:		
Production	1,518,677	550,692
General and administration	481,695	214,107
Interest	506,318	–
Depletion and amortization	2,368,354	718,995
Site restoration	185,750	56,349
	5,060,794	1,540,143
Income before income taxes	3,639,338	1,891,065
Provision for income and other taxes (note 8):		
Future income tax	1,173,012	–
Deferred income tax	–	687,000
Large corporations tax	50,000	–
	1,223,012	687,000
Net income	2,416,326	1,204,065
Retained earnings, beginning of year	2,921,280	1,717,215
Retained earnings, end of year	$ 5,337,606	$ 2,921,280
Net income per share:		
Basic	$ 0.23	$ 0.13
Fully diluted	$ 0.22	$ 0.11

See accompanying notes to consolidated financial statements.

SUNFIRE ENERGY CORPORATION

Consolidated Statement of Cash Flows

Year ended December 31, 2000, with comparative figures for 1999

	2000	1999
Cash provided by (used in):		
Operations:		
Net income	$ 2,416,326	$ 1,204,065
Items not involving cash:		
Depletion and amortization	2,368,354	718,995
Future income tax	1,173,012	–
Deferred income tax	–	687,000
Site restoration provision	185,750	56,349
Funds from operations	6,143,442	2,666,409
Change in non-cash operating working capital	(1,521,229)	1,112,789
	4,622,213	3,779,198
Financing:		
Common shares issued	2,732,100	2,267,450
Share issue costs	–	(42,807)
Increase in long-term debt	5,644,940	–
Obligation under capital lease	1,994,872	–
Principal repayment under capital lease obligation	(82,419)	–
	10,289,493	2,224,643
Investments:		
Petroleum and natural gas properties	(11,530,936)	(5,460,434)
Acquisition of Braegan Energy Ltd. (note 3)	(5,145,905)	–
Acquisition of 725620 Alberta Ltd. (note 3)	(412,610)	–
Site restoration costs	(50,884)	(37,106)
	(17,140,335)	(5,497,540)
Increase (decrease) in cash	(2,228,629)	506,301
Cash, beginning of year	2,237,770	1,731,469
Cash, end of year	$ 9,141	$ 2,237,770
Cash flow per share:		
Basic	$ 0.58	$ 0.29
Fully diluted	$ 0.55	$ 0.29

During 2000, the Corporation paid $489,841 (1999 - $nil) of interest on long-term debt.

See accompanying notes to consolidated financial statements.

The Company is engaged in the exploration for and production of petroleum and natural gas in Alberta.

1. Significant accounting policies:

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant policies summarized below:

(a) Petroleum and natural gas properties:

The Company follows the full cost method of accounting for petroleum and natural gas operations, whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized. Such costs include land acquisition costs, cost of drilling both productive and non-productive wells, related plant and production equipment costs, and geological and geophysical expenses and overhead directly related to these activities.

Capitalized costs, excluding costs relating to unproven properties, are depleted and depreciated using the unit-of-production method based on estimated gross proven reserves of petroleum and natural gas before royalties as determined by independent petroleum engineers. For purposes of the depletion and depreciation calculation, natural gas reserves and production are converted to equivalent volumes of crude oil based on relative energy content.

The costs of acquiring and evaluating unproved properties are excluded from depletion calculations. These properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of impairment is added to costs subject to depletion.

The Company applies a "ceiling test" to capitalized costs to ensure that the net costs capitalized do not exceed the estimated future net revenues from the production of its proven reserves, plus the cost of undeveloped lands, less impairment. Future net revenues are calculated at year end prices and include an allowance for estimated future general and administrative expenses, interest expense and income taxes.

Proceeds from the sale of petroleum and natural gas properties are applied against capital costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation.

1. Significant accounting policies (continued):

(a) Petroleum and natural gas properties (continued):

Depreciation of furniture and office equipment is provided using the declining balance method based upon estimated useful lives at rates of 20% to 100%.

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(b) Interest in joint ventures:

Substantially all of the Company's petroleum and natural gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(c) Future site restoration and abandonment costs:

Estimated site restoration and abandonment costs are provided for over the life of the estimated proven reserves on a unit-of-production basis. Costs are estimated each year by management in consultation with the Company's engineers based on current regulations, costs, technology and industry standards. The period charge is expensed and actual site restoration and abandonment expenditures are charged to the accumulated provision account as incurred.

(d) Per share amounts:

Per share amounts are calculated based on the weighted average number of common shares outstanding. Fully diluted amounts give effect to the issuance of common shares for options, and warrants as if they had been issued at the later of the beginning of the year or the issue date.

(e) Flow-through shares:

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Share capital is reduced and a future income tax liability is recorded for the estimated cost of the renounced tax deductions when the expenditures are renounced.

1. Significant accounting policies (continued):

(f) Financial instruments:

The Company periodically enters into derivative instrument contracts to manage exposure related to petroleum and natural gas prices. Settlement amounts on commodity and foreign currency hedge contracts are recognized in earnings as the related production revenues are recorded (see note 9).

The carrying value of current assets and current liabilities approximate their fair value due to the relatively short period to maturity of the instruments.

(g) Stock option plan:

The Company has a stock option plan which is described in note 7. When stock options are granted, no compensation expense is recorded. Consideration received on the exercise of the stock option is credited to share capital.

(h) Income taxes:

Effective January 1, 2000, the Company retroactively adopted the liability method of accounting for future income taxes without restatement of prior periods. Under the liability method, future income tax assets and liabilities are determined based on "temporary differences" (differences between the accounting basis and the tax basis of the assets and liabilities), and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse. Income tax expense or benefit is the sum of the Company's provision for current income taxes and difference between the opening and ending balances of the future income tax assets and liabilities.

Prior to adoption of this new standard, income tax expense was determined using the deferral method. Under this method, deferred income tax expense was determined based on "timing differences" (differences between the accounting and tax treatment of items of expense or income), and were measured using the tax rates in effect in the year the differences originated.

2. Change in accounting policy:

Effective January 1, 2000, the Company changed its method of accounting for taxes from the deferral method to the liability method described in note 1 and has applied this change retroactively without restating prior periods. At January 1, 2000, the future income tax liability was increased by $1,574,820, property, plant and equipment was increased by $1,707,330 and share capital was increased by $132,510. These adjustments were a result of recognizing the future income tax costs of renouncing deductions to flow-through share subscribers.

3. Acquisitions:

(a) Acquisition of Braegan Energy Ltd.:

On March 14, 2000, the Company acquired all the outstanding shares of Braegan Energy Ltd. The acquisition was accounted for using the purchase method with the purchase price allocated as follows:

Current assets	$ 523,442
Petroleum and natural gas properties	9,337,835
Current liabilities	(2,145,887)
Future income tax liability	(2,533,165)
Site restoration	(36,320)
Cash consideration for net assets acquired	$ 5,145,905

(b) Acquisition of 725620 Alberta Ltd.:

On June 23, 2000, the Company acquired all the outstanding shares of 725620 Alberta Ltd. The acquisition was accounted for using the purchase method with the purchase price allocated as follows:

Current assets	$ 90,196
Current liabilities	(130,943)
Petroleum and natural gas properties	719,508
Future income tax liability	(266,151)
Cash consideration for net assets acquired	$ 412,610

4. Petroleum and natural gas properties:

	2000	1999
Petroleum and natural gas properties	$ 39,805,439	$ 16,509,830
Less accumulated depletion and depreciation	(6,705,594)	(4,337,240)
	$ 33,099,845	$ 12,172,590

At December 31, 2000, petroleum and natural gas properties include $1,994,872 (1999 - $nil) of assets under capital lease.

Unproved properties with a cost of approximately $1,158,503 (1999 - $1,129,282) included in petroleum and natural gas properties have not been subject to depletion.

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5. Long-term debt:

The Company has a credit facility available to $7,700,000 with interest at prime bank lending rate plus ¾% which is collateralized by a general assignment of book debts, general security agreement, and an $18,000,000 first and floating charge debenture with a first fixed charge registered on all petroleum and natural gas properties with a discounted reserve value greater than $150,000. The facility maximum reduces by $425,000 per quarter commencing March 31, 2001.

6. Obligations under capital lease:

Future lease commitments relating to the acquisition of a compressor, excluding interest at 8.125%, payable by the Company are as follows:

2001	$ 446,851
2002	457,287
2003	353,919
2004	654,396
Total lease payments	1,912,453
Current portion of obligation under capital lease	446,851
	$ 1,465,602

Interest of $26,460 relating to capital lease obligations has been included in interest expense.

7. Share capital:

(a) Authorized:

Unlimited number of Class A voting common shares

Unlimited number of Class B non-voting common shares

Unlimited number of Class C, D and E preferred shares

(b) Issued:

Class A common shares	Number of shares	Amount
Balance, December 31, 1998	9,001,818	$ 7,420,587
Issuance of flow-through common shares	965,755	2,172,950
Tax effect of flow-through common shares	–	(969,135)
Share issue costs	–	(42,807)
Issue of shares on exercise of stock options	135,000	94,500
Balance, December 31, 1999	10,102,573	8,676,095
Issuance of common shares on exercise of stock options	50,000	35,000
Issuance of common shares on exercise of warrants	1,500,000	1,600,000
Issuance of flow-through common shares	414,000	1,097,100
Tax effect on flow-through shares	–	(489,307)
Change in accounting policy (note 2)	–	132,510
Balance, December 31, 2000	12,066,573	$ 11,051,398

(c) Flow-through shares:

On December 28, 2000, the Company completed the private placement of 414,000 flow-through Class A common shares at $2.65 per share. Share capital was reduced and future income taxes were increased by the estimated amount of the tax benefits renounced.

On December 2, 1999, the Company completed a private placement of 965,755 flow-through Class A common shares at $2.25 per share.

7. Share capital (continued):

(d) Stock options:

Under an incentive stock option plan, the Company has granted 900,000 stock options to purchase common shares of the Company to directors and employees of the Company. The following table summarizes the changes in the Company's stock option plan:

	2000		1999	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock options outstanding, beginning of year	550,000	$ 0.95	660,000	$ 0.86
Granted	400,000	1.38	25,000	1.90
Cancelled	–	–	–	–
Exercised	(50,000)	0.70	(135,000)	0.70
Stock options outstanding, end of year	900,000	$ 1.15	550,000	$ 0.95
Stock options exercisable, end of year	790,000	$ 1.11	550,000	$ 0.95

The following table summarizes information about stock options outstanding and exercisable as at December 31, 2000:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding	Weighted-average remaining contractual life	Weighted-average exercise price	Number exercisable	Weighted-average exercise price
$ 0.70 – 1.10	475,000	2.6 years	$ 0.92	475,000	$ 0.92
1.25 – 1.50	390,000	3.2 years	1.36	290,000	1.36
1.90 – 2.05	35,000	4.0 years	1.94	25,000	1.90
$ 0.70 – 2.05	900,000	2.9 years	$ 1.15	790,000	$ 1.11

(e) Warrants:

In connection with a private placement undertaken by the Company on April 30, 1998, the Company issued 500,000 warrants. Each warrant entitled the holder to purchase one Class A common share at $0.70 per share on or before April 30, 2000. In connection with a private placement undertaken by the Company on December 31, 1998, the Company issued 1,000,000 warrants. Each warrant entitles the holder to purchase one Class A common share at $1.25 per share on or before December 18, 2000. Both groups of warrants were exercised during 2000.

8. Income taxes:

(a) The provision for income taxes differs from the amount obtained by applying the combined Federal and Provincial income tax rate of 44.6% to income before income taxes. The difference relates to the following items:

	2000	1999
Income tax rate	44.6%	44.6%
Expected income tax provision	$ 1,623,145	$ 843,400
Non-deductible crown charges	846,115	290,900
Alberta Royalty Tax Credit	(187,920)	(187,700)
Resource allowance	(895,093)	(238,500)
Other	(213,235)	(21,100)
	$ 1,173,012	$ 687,000

The components of the future income tax liability at December 31, 2000 are as follows:

Future income tax assets:	
Share issue costs	$ 45,234
Future site restoration	95,402
	$ 140,636
Future income tax liabilities:	
Petroleum and natural gas properties	$ 7,416,591
Net future income tax liability	$ 7,275,955

(b) At December 31, 2000, the Company has approximately $15.6 million of resource and other unused income tax pools available for deduction against future taxable income.

(c) Cash income taxes paid during the year were $nil (1999 - $nil).

9. Financial instruments:

(a) Credit risk:

A substantial portion of the Company's accounts receivable are with customers and joint venture partners in the petroleum and natural gas industry and are subject to normal industry credit risks. Purchasers of the Company's natural gas, crude oil and natural gas liquids are subject to an internal credit review to minimize the risk of non-payment.

(b) Commodity risk:

The Company seeks to reduce its exposure to commodity price risk in its business through the use of physical product arrangements, futures, and options.

The Company has entered into a fixed price contract on a total of 4,000 GJ/day of natural gas at a floor price of $4.78/GJ until March 31, 2001.

(c) Fair value of financial instruments:

The carrying amounts of financial instruments included in the balance sheet, other than long-term debt, approximate their fair value due to their short-term maturity. The long-term debt's carrying value approximates fair value due to the cost of borrowing being at a floating rate.

NOTES

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CORPORATE INFORMATION

DIRECTORS

Geoffrey C. Merritt *(1)*
Calgary, Alberta
President of the Corporation

Roderick Campbell *(1,3)*
Calgary, Alberta
Business Consultant

Douglas H. Mitchell *(2,3)*
Calgary, Alberta
Co-Chairman and Managing Partner
of Borden Ladner Gervais LLP

William R. Stedman *(1,2)*
Calgary, Alberta
Chairman and CEO
of ENTX Capital Corporation

James M. Stanford *(3)*
Calgary, Alberta
President of Stanford Resource Management

(1) Member of Audit Committee
(2) Member of Compensation Committee
(3) Member of Corporate Governence Committee

AUDITORS

KPMG LLP
Calgary, Alberta

BANKERS

HSBC Bank of Canada
Calgary, Alberta

EVALUATION ENGINEERS

Martin & Brusset Associates
Calgary, Alberta

LEGAL COUNSEL

Borden Ladner Gervais LLP
Calgary, Alberta

STOCK EXCHANGE LISTING

Canadian Venture Exhange
Trading Symbol SFE.A

TRANSFER AGENT AND REGISTRAR

Computershare Trust Company of Canada
Calgary, Alberta

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